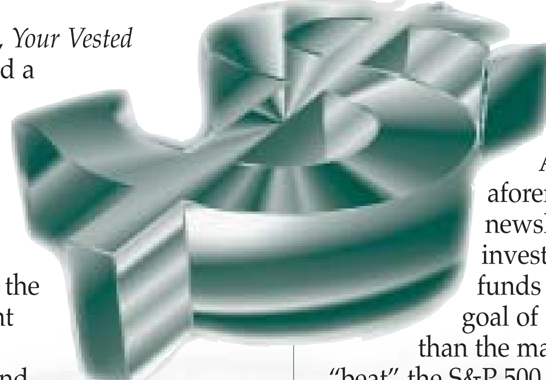
Your VESTED INTEREST

North Dakota State Investment Board

September 2004

INVESTMENT RETURNS BOUNCE BACK



Last September, *Your Vested Interest* reviewed a number of concepts that have lasting pertinence to understanding the investment performance of the State Investment Board's (SIB) Pension Trust and its two 800-pound gorillas, the TFFR and PERS defined benefit plans. We reviewed the concepts of "floating bar charts" and how a relative under or over-exposure to stocks versus bonds can impact performance over a given period. The article concluded by pointing out that TFFR and PERS have differing amounts of stocks and bonds and one of the funds will typically outperform the other depending on whether stocks or bonds are the better market for the fiscal year period.

With this issue, we close the books on Fiscal Year 2004. Happily it can be reported that the market for stocks was much more vibrant this past year, which means that our pension plans had the opportunity to participate in a better return environment. The bond market, which has been one of the only friendly places to be for the prior three years, finally disappointed investors with a flat return for the year. Bonds don't tend to fluctuate as much as stocks and are generally more conducive to being rationally analyzed. That said, because interest rates rose in FY04, bond values declined, offsetting the income they generated.

As explained in the aforementioned newsletter, the SIB invests the pension funds with a long term goal of "doing better" than the markets. If our stocks "beat" the S&P 500 Index, we "did better." Same goes for bonds relative to the Lehman Aggregate Bond Index. It is good to share then, that our stock and bond portfolios "beat the markets" in FY04, just as they did in FY03. The difference is that the stock market was so robust in FY04, that beating it meant very impressive returns for TFFR and PERS, both of which have a significant portion of their assets invested in the stock market.

The performance charts inside portray a visual of the excellent year we had in investments. While the prior three years were devastating to the stock market, returns such as these go a long way towards shoring up the value of the TFFR and PERS funds. Keep in mind that these funds also have liabilities that continue to add up whether the markets are good or bad. In this article, we are focusing on the "asset side" of the equation and not relating assets to liabilities. That conversation aside, isn't it nice to get a break…finally???

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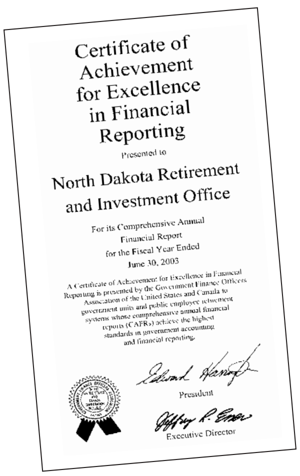


ACHIEVEMENT AWARD RECEIVED

The ND Retirement and Investment Office (RIO) is pleased to announce that its Comprehensive Annual Financial Report (CAFR) for June 30, 2003 has qualified for a Certificate of Achievement for Excellence in Financial Reporting from the Government Finance Officers Association (GFOA).

The Certificate of Achievement is the highest form of recognition in public employee retirement system accounting and financial reporting, and its attainment represents a significant accomplishment. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

FROM THE DIRECTOR'S CHAIR

After reading the front page article in this edition of *Your Vested Interest*, I was feeling pretty good about the financial condition of our pension plans. I enjoyed that good feeling for several moments until the last couple of sentences of the article began to haunt me. Liabilities…the other side of the equation.

Our pension plans are defined benefit plans, which means that we know, even while we are still working, how much our benefit is likely to be in the future. Our pension plans make monthly payments to all beneficiaries who are entitled to them. These payments are calculated by a formula using an average salary and years of service. The result is a fixed monthly amount of money being paid out to each recipient.

Where do these monthly benefits come from? The pools of money we call the pension plans, of course. And the North Dakota plans have thousands of members. Each of those members who gets a raise or works another year is entitled to a larger future benefit. In addition, if they retire at a relatively young age, and live long lives as so many do in this beautiful state, those benefit checks will come from the pension plan for a very long time. So from the standpoint of the pension plans, these future payouts are liabilities. Not unlike the future house payments so many of us know we will have to make or other future known expenses.

Let's say we had a stream of monthly payments and we were able to cover it with our monthly salary. Then, for some reason, our salary was cut significantly for three years. Unfortunately, the payments we owe could not be reduced. This would put us in a bind. Now, say at the end of the three years, our salary got back to where it used to be. That would be terrific for meeting current obligations, but we would still have to deal with the problem of the past three years. This is a case where our assets (salary) declined for an extended period while our liabilities (monthly payments) remained. Do you see the problem here?

Let's take a hypothetical defined benefit pension plan. The plan has $1 billion in assets. In order to fund future liability payments, the plan is expected to earn 8 percent per year from its investments. Then the assets in the plan take a three year decline due to a weak stock market. At the end of three years, the fund has $800 million, having lost $200 million in market value. Now in the fourth year, the markets improve and the fund returns to $1 billion. No more problem, right? I wish! The problem is that the liabilities continued to grow while the plan failed to earn the 8 percent return needed to maintain the same financial status it previously had. In the last four years, this imaginary plan went from $ 1 billion to $1 billion, a return of zero. If instead, it had grown 8 percent each year; it would have grown to approximately $1.4 billion. Now the plan needs more than 8 percent per year to catch up to where it would have been, and that takes time. If you think about it, it would be difficult for a plan such as this to make benefit improvements that would increase its liabilities, because it is still catching up to the level needed to fully fund existing liabilities.

This example is presented to clearly outline the principles of the relationship between assets and liabilities. How does this relate to you? It simply provides additional insight into the management of pension plans. Our pension plans are unique and independent. The administrators of your plan provide information that is specific to the plan. If you are seeking to understand the funding of your plan, these concepts may help you. And now that I have all but confused myself, I will sign off with a "thanks" for hanging in there with me through that!

Ron Leingang

Charles "Sandy" Blunt

Lonny Mertz

NEW SIB MEMBERS

The SIB would like to welcome two new members. Ron Leingang represents PERS on the SIB. Ron was employed with state and county government for 36 years and represents retired state employees on the PERS Board. Charles "Sandy" Blunt, the new Executive Director and CEO of Workforce Safety and Insurance also serves on the State Investment Board.

SIB AUDIT COMMITTEE

The SIB Audit Committee also has a new representative in 2004-05. Lonny Mertz from Job Service of North Dakota has replaced Korrine Lang.

Lt. Governor
Jack Dalrymple
Chairman

SIB ELECT OFFICERS

The State Investment Board (SIB) recently held its annual election of officers. The SIB chose the following members to hold leadership positions for the 2004-2005 fiscal year.

Howard Sage
Vice-Chair

TARGET ASSET ALLOCATION FOR PERS & TFFR

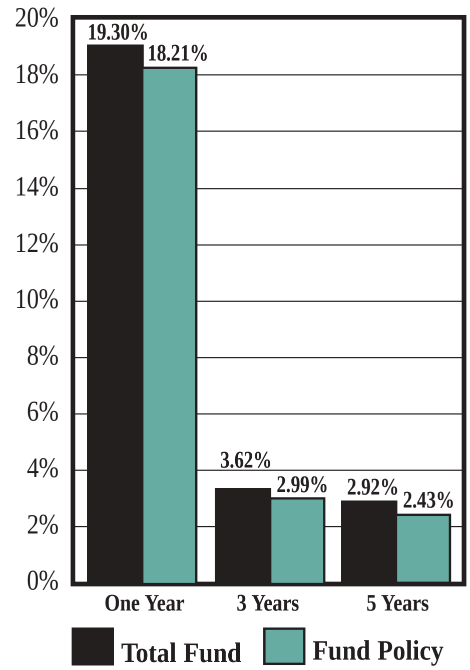
Period Ended June 30, 2004

ASSET ALLOCATION	PERS	TFFR
Domestic Large Cap Equity	30%	30%
Domestic Small Cap Equity	10%	10%
International Equity	10%	20%
Emerging Markets Equity	5%	5%
Private Equity	5%	5%
Domestic Fixed Income	24%	7%
High Yield Fixed Income	5%	7%
International Fixed Income	5%	5%
Real Estate	5%	9%
Cash Equivalents	1%	2%
Total Fund	**100%**	**100%**

INVESTMENT PERFORMANCE

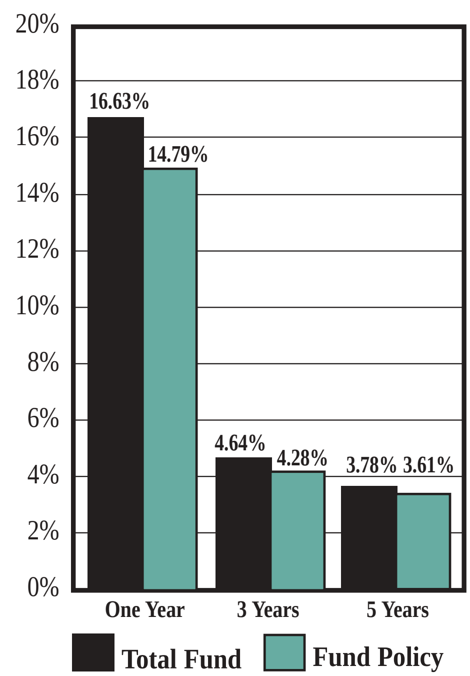
TFFR

June 30, 2004



PERS

June 30, 2004



IN REMEMBRANCE

Norm Stuhlmiller passed away on August 21, 2004, leaving a legacy of service to the State Investment Board (SIB) that shall be long remembered. As a representative of retired teachers on the Teachers' Fund for Retirement (TFFR) board, Norm was one of three TFFR trustees to sit on the eleven-member SIB. He served in that capacity for over 9 years and his attendance record underscores his dedication to the funds served by the SIB. His keen interest in investments was fed by the many complex and innovative investment strategies that were studied and incorporated in the SIB program during his tenure. As Parliamentarian to the SIB, Norm kept our governance program on track and was always ready with an answer to a technical question regarding Robert's Rules of Order. In addition to his service on the board, Norm also served on the SIB Audit Committee, the only standing committee of the board. When a volunteer was needed for an ad-hoc committee, Norm would pull out his appointment book and find a way to help out. As an active board member, Norm was a frequent visitor to the RIO office and always a cheerful face in the crowd. Staff members looked forward to the tasty treats that he would leave in the break room, just one of many ways he showed staff how much he appreciated the work they do. Always there with a positive point of view or a touch of much needed humor, Norm will be missed by all.

Norm Stuhlmiller

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